

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF ILLINOIS

IN RE:)
)
DAVID K. OGDEN and) Bankruptcy Case No. 97-30640
DONNA J. OGDEN,)
)
Debtors.)
)
MAGNA BANK, N.A.,)
)
Plaintiff,)
vs.) Adversary Case No. 97-3095
)
DAVID OGDEN and)
DONNA OGDEN,)
)
Defendants.)

OPINION

This matter having come before the Court for trial on a Complaint Under Section 523 filed by the Plaintiff on May 15, 1997; the Court, having heard sworn testimony and arguments of counsel and being otherwise fully advised in the premises, makes the following findings of fact and conclusions of law pursuant to Rule 7052 of the Federal Rules of Bankruptcy Procedure.

Trial in this matter was held on June 1, 1998, at which time the Court heard nearly nine hours of testimony, including testimony from two bankers and from the Defendants, David K. Ogden and Donna J. Ogden. At the conclusion of trial, the Court found in favor of the Plaintiff and against the Defendants finding that the debt in question, due from the Defendants to the Plaintiff, was nondischargeable pursuant to 11 U.S.C. § 523(a)(6). The Court now enters the written findings of fact and conclusions of law in support of its ruling at the close of trial.

Findings of Fact

The facts in this matter are not in serious dispute and are, in pertinent part, as follows:

1. The Debtors/Defendants, David K. Ogden and Donna J. Ogden, filed a voluntary petition for relief pursuant to Chapter 7 of the Bankruptcy Code, on March 5, 1997.

2. The Plaintiff, Magna Bank, N.A., N.A., is a successor to Magna Bank, N.A. of Illinois, a creditor of the Debtors scheduled in their bankruptcy petition.

3. From 1991 until the end of January 1997, Debtor, David K. Ogden, owned and operated a sole proprietorship, which he called Automation Services. The Debtors possessed two checking accounts. The business checking account, upon which Debtors wrote checks related to their business, was kept at Magna Bank, N.A. Debtors' personal checking account, upon which personal checks were written, was kept at Central Bank.

4. Debtor, Donna J. Ogden, assisted her husband, David, in operating the business known as Automation Services.

5. The Debtors, through the business, Automation Services, marketed, designed, fabricated, and installed customized conveyor systems for industrial clients.

6. In order to finance the daily needs of Automation Services, Debtors obtained a revolving line of credit from Magna Bank, N.A., which is evidenced by a promissory note dated April 8, 1994, in the principle sum of \$25,000, (hereinafter referred to as "Note #1 "). Note #1 originally matured on April 10, 1995, and was extended through various modifications until it became fully due and payable on October 10, 1996. Magna Bank, N.A. is the holder and current owner of Note #1.

7. As of the petition date, Debtors owned \$22,550 in principle, plus interest, costs, and attorney's fees, to Magna on Note #1. Note #1 was secured by a security interest in Debtors' accounts, instruments, documents, chattel paper, and other rights to payments, as evidenced in the "Security Interest" portion of Note #1. Note #1 was also secured by a security interest in equipment, inventory, accounts, and general intangibles owned by Debtor, David K. Ogden, and as evidenced by a Commercial Security Agreement executed by David K. Ogden in favor of Magna Bank, N.A., dated April 10, 1995.

8. Over time, Automation Services was awarded projects for large industrial clients, such as the Eureka Company and Bombardier, Inc. Debtors needed additional sums of money in addition to the revolving line of credit in order to finance these projects.

9. In May 1995, Automation Services was awarded a \$138,340 contract with the Eureka Company in Juarez, Mexico, (hereinafter referred to as the "Eureka Contract").

10. In order to finance Automation Services' purchases of materials and supplies for the Eureka Contract, Debtors requested a 180 day note from Magna Bank, N.A. in the amount of \$75,000. Magna Bank, N.A. agreed to loan Debtors \$75,000 to allow them to purchase materials and supplies for the Eureka Contract. The loan for the Eureka Contract is evidenced by a promissory note dated May 12, 1995, in the principle amount of \$75,025, which was thereafter extended by various modifications until it finally became fully due and payable on October 12, 1996, (hereinafter referred to as Note #2). As of the date of Debtors' bankruptcy petition, Debtors owed Magna Bank, N.A. \$73,729.70 in principle, plus interest, attorney's fees, and costs on Note #2. Magna Bank, N.A. is the current owner and holder of Note #2. Note #2 was secured by a security interest in Debtors' accounts, other rights to payment, and, specifically, the Eureka Contract, as evidenced by a Commercial Security Agreement executed by Debtors in favor of Magna Bank, N.A., dated May 12, 1995.

11. Prior to the maturity date of Note #2, Automation Services was awarded a \$280,000 contract with Bombardier, Inc., in Benton, Illinois, (hereinafter referred to as the "Bombardier Contract").

12. In order to finance Automation Services' purchase of materials and supplies for the Bombardier Contract, Debtors borrowed an additional \$75,000 from Magna Bank, N.A. on a 180 day note. In October 1995, Magna Bank, N.A. agreed to loan Debtors \$75,000 for the Bombardier Contract. The loan for the Bombardier Contract is evidenced by a promissory note dated October 27, 1995, in the principle amount of \$75,005, which was thereafter extended various times until it became fully due and payable on October 15, 1996, (hereinafter referred to as Note #3). As of the petition date, Debtors owed \$74,600 in principle, plus interest, costs, and attorney's fees, to Magna Bank, N.A. on Note #3. Magna Bank, N.A. is the current owner and holder of Note #3. As in the past, Note #3 was secured by a security interest in the Bombardier Contract, as evidenced by a Commercial Security Agreement executed by the Debtors in favor of Magna Bank, N.A., dated October 27, 1995. In addition to the Commercial Security Agreement on the Bombardier Contract, the Debtors also executed a Notice of Assignment of Accounts, Contract Rights, and Income, which provided that, upon notice to Bombardier, Inc. by Magna Bank, N.A., Bombardier, Inc. was required to direct payments to Magna Bank, N.A., rather than pay directly to Automation Services. Evidence indicates, although the Notice of Assignment of Accounts was executed,

no notice was ever sent to Bombardier, Inc. by Magna Bank, N.A. requiring direct payments to the Bank.

13. On or about November 1, 1995, Donna J. Ogden, on behalf of Automation Services, wrote Magna Bank, N.A. requesting an extension of Note #2, because the project at issue in the Eureka Contract was not to be completed until January 1996, which was later than previously thought. Donna J. Ogden's letter indicated that the Debtors were to receive a payment from Eureka Company in December 1995 and a payment in February 1996. Accordingly, Donna J. Ogden requested that Magna Bank, N.A. modify Note #2 to require one-half of it to be paid in December 1995, with the remaining balance due in February 1996. This letter request was granted by Magna Bank, N.A., and Magna Bank, N.A. and Debtors agreed to the terms contained in a Change in Terms Agreement, which modified Note #2 calling for interest payments to be made in December 1995 and January 1996, with the remaining principle and interest to be paid on Note #2 in February 1996.

14. In December 1995, the Debtors required additional funding for the Bombardier Contract. Based upon a request, Magna Bank, N.A. agreed to extend Debtors an additional \$45,000 for the Bombardier Contract. This second loan for the Bombardier Contract is evidenced by a promissory note dated December 7, 1995, in the principle amount of \$45,005, which was thereafter extended by various modifications until it became fully due and payable on October 15, 1996, (hereinafter referred to as Note #4). As of the Debtors' Chapter 7 petition date, Debtors owed \$45,000 in principle, plus interest, costs, and attorney's fees, to Magna Bank, N.A. on Note #4. Note #4 was secured by a security interest in the Bombardier Contract, as evidenced by a Commercial Security Agreement executed by the Debtors in favor of Magna Bank, N.A., dated December 7, 1995.

15. In late December 1995, the Debtors began having disputes with Bombardier, Inc., and, in mid-January 1996, the Debtors ceased their relationship with Bombardier, Inc. and began instituting a series of actions to attempt to force Bombardier, Inc. to pay Automation Services what the Ogdens believed was owed. Among the methods employed by the Ogdens to force Bombardier, Inc. to pay included passing out flyers against Bombardier, Inc. at various boat shows around the country, filing a mechanic's lien against Bombardier, Inc.'s property, and developing a page on the Internet to warn potential contractors of the Ogdens' view of Bombardier, Inc.'s actions in their dealings together.

16. In January 1996, Debtors were told by the Eureka Company that they need not return to the job site in Juarez, Mexico, as a dispute had arisen between the Ogdens and Eureka Company as to the amount which Eureka owed to the Ogdens for their work.

17. In February 1996, Bombardier, Inc. brought suit against the Ogdens seeking damages for the Ogdens' alleged breach of contract, fraud, tortious interference, and defamation. The Ogdens counter-claimed against Bombardier, Inc. for breach of contract and to foreclose their mechanic's lien. Also in February 1996, Note #2 was extended by Magna Bank, N.A. because Debtors had not received final payment for their services on the Eureka Contract.

18. All four of the notes outlined above between the Ogdens and Magna Bank, N.A. matured in October 1996. At that time, the Ogdens did not possess the funds to bring the interest on the debts current, and, as such, the debts were declared matured and Magna Bank, N.A. would not further agree to any more extensions.

19. In November 1996, the funds contained in the Ogdens' business checking account at Magna Bank, N.A. were set off. The Ogdens were able to convince Magna Bank, N.A. to restore the funds to their account, but the four notes with Magna Bank, N.A. were never extended beyond their October 1996 due dates. Following the set off of their business checking account in November 1996, it is apparent that Debtors knew that Magna Bank, N.A. expected payment on the four notes then due it, and that the Bank was interested in pursuing whatever means of payment was possible. At the same time, Debtors also admitted to having received notices from Magna Bank, N.A. which indicated that all the notes that they had with the Bank had matured such that the Ogdens were required to pay the full amount of principle and interest owing on all of these debts.

20. In December 1996, Debtors wrote to Magna Bank, N.A. asking it to place their accounts in "non accrual status" until the Ogdens had completed their litigation with Bombardier, Inc., which had been set for trial in June 1997. "Non accrual status" is merely an accounting method by which a bank stops showing the interest for the loan as income. This is done when, among other reasons, the recovery of interest on a particular debt is unlikely to occur as documented. Placing a loan in "non accrual status" does not stop the bank from accruing interest or from taking collection actions. Although Magna Bank, N.A.

agreed to put the debts from the Ogdens in "non accrual status, " the Debtors were never informed by Magna Bank, N.A. that the Bank would agree to extend their debts, and Debtors knew that the loans would not be extended. Additionally, the Ogdens were never informed by Magna Bank, N.A. that it would wait until the litigation with Bombardier, Inc. was complete before seeking payment on the debts.

21. Sometime during December 1996, David K. Ogden phoned the Eureka Company and agreed to settle his dispute over the amount to be paid on the Eureka Contract for the sum of \$57,461, (hereinafter referred to as the "Eureka Funds"). On January 2, 1997, the Ogdens executed a release in favor of Eureka Company so that they could receive the Eureka Funds which were subsequently paid to the Ogdens directly on January 6, 1997. A few days prior to the receipt of the Eureka Funds, the Debtors met with Attorney David Lumerman and discussed the filing of a Chapter 7 bankruptcy. Attorney Lumerman eventually did represent the Debtors in their Chapter 7 proceeding.

22. Upon receipt of the Eureka Funds, the Ogdens did not deposit those funds into their business checking account at Magna Bank, N.A. Rather, the funds were deposited in their personal account at Central Bank. The testimony at trial indicated that the Eureka Funds were not distributed into the business account at Magna Bank, N.A. because Magna Bank, N.A. was not "working with" the Ogdens. Within six days of Debtors' receipt and deposit of the Eureka Funds into their personal checking account at Central Bank, the Ogdens wrote approximately 78 checks from that account, amounting to approximately \$46,000 in funds. Another 26 checks were written from the Ogdens' personal checking account by the end of January 1997, amounting to approximately an additional \$11,500. Plaintiff's evidence showed that, in the months prior to January 1997, only a handful of checks were written on the Ogdens' personal checking account at Central Bank in each month. Thus, the writing of approximately 104 checks within a one month time period was a highly unusual use of the Ogdens' personal checking account. Although the Ogdens testified that the personal checking account was used solely to attempt to keep the business of Automation Services going, the evidence indicates that a significant amount of money was spent other than on the business. Among the expenditures, Debtors used \$12,146.94 to pay non-dischargeable Federal and State taxes. The Debtors used another \$2,747.24 of the Eureka Funds to pay their December 1996 house payment, their January 1997 house payment, and to pre-pay their February 1997 house

payment. Additionally, the Ogdens used over \$20,600 of the Eureka Funds to pay creditors on account for services or personalty purchased prior to January 1997. The Ogdens gave over \$750 to charities, friends, and relatives. The Debtors also paid over \$800 to purchase books on tape, books, fish and bird feed, cash, personal stationery, video tapes, a massage table, and other miscellaneous, unnecessary, non-business related items. None of the money received from the Eureka Funds was ever paid to Magna Bank, N.A.

23. Credible evidence adduced at trial showed that the Ogdens knew that the Eureka Funds received on January 6, 1997, were collateral for Note #2 and that they were obligated to pay those funds to Magna Bank, N.A.

24. Magna Bank, N.A. showed that it was damaged by the Debtors' failure to pay over the Eureka Funds to it in that the debts owed to Magna Bank, N.A. by the Ogdens at the time of the receipt of the Eureka Funds far exceeded the amount received by the Debtors from the Eureka

Company. Evidence further indicates that the Ogdens did not inform Magna Bank, N.A. that they were negotiating a settlement with the Eureka Company, nor did they ever inform the Bank that the dispute with the Eureka Company had been settled, a release executed, and the funds received on January 6, 1997. In fact, the Ogdens never disclosed their receipt of the Eureka Funds until after said funds had been spent.

Conclusions of Law

Pursuant to 11 U.S.C. § 523(a)(6):

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt -

(6) for willful and malicious injury by the debtor to another entity or to the property of another entity;

See: In re Iaguinta, 95 B.R. 576 (Bankr. N.D. Ill. 1989); In re Miceli, 1991 WL 242981 (Bankr. N.D. Ill. 1991); In re Wolfson, 148 B.R. 638 (Bankr. M.D. Fla. 1992).

The phrase "willful and malicious injury" has been held to include a willful and malicious conversion. In re Lampi, 152 B.R. 543 (Bankr. C.D. Ill. 1993); In re Meyer, 7 B.R. 932, at 933 (Bankr. N.D. Ill. 1981); and also Miceli, supra, at 11 and 12. Under Illinois law, the essence of an action for conversion is the wrongful deprivation of property from a person entitled to possession thereof. See: Glaser v. Kazak, 173 Ill. App.3d 108, 527 N.E.2d 379 (1988). It has been held that, where a debtor disposes of collateral to the detriment of a secured creditor, the debtor commits an act of conversion which is nondischargeable under 11 U.S.C. § 523(a)(6). See: Meyer, supra, at 933; Miceli, supra, at 12; and In re Stelluti, 94 F. 3d 84 (CA 2, 1996).

Under the Bankruptcy Code, the term "willful" is consistently defined by the Courts as a deliberate or intentional action. See: Iaguinta, supra, at 924; In re Nunez, 95 B.R. 566 (Bankr. N.D. Ill. 1988); and In re Sain, 101 B.R. 30, at 32 (Bankr. C.D. Ill. 1988). A "malicious" act is one which is wrongful and done without just cause or excuse. An actual intent to harm the creditor is not required. Courts recognize an implied or constructive malicious intent where the wrongful, intentional act necessarily results in harm. In re Scarlata, 112 B.R. 279 (Bankr. N.D. Ill. 1990); Iaguinta, supra, at 924; and In re Nelson, 35 B.R. 765 (Bankr. N.D. Ill. 1983). However, a "merely technical or innocent conversion or one under mistake, absent aggravated features does not strictly constitute willful and malicious injury". United Bank of South

Gate v. Nelson, 35 B.R. 766, at 777 (D.C. N.D. Ill. 1983). It has been held that the debtor must know his act will harm the creditor's interest and yet "proceed in the face of that knowledge". United Bank of South Gate v. Nelson, supra, at 776; and Scarлата, supra, at 290.

In applying the law under 11 U.S.C. § 523(a)(6) to the instant fact pattern, the Court finds that the Debtors/Defendants herein knew that the proceeds of the Eureka Contract were secured collateral of Magna Bank, N.A., and, in the face of that knowledge, the Debtors proceeded to dispose of the funds from the Eureka Contract to the detriment of Magna Bank, N.A. Although the Debtors both testified that the purpose of placing the Eureka Funds in an account other than at Magna Bank, N.A. was solely for the purpose of keeping the Automation Services business going, the testimony of the Debtors in this case is not credible. In observing the demeanor of the Debtors, the manner in which they testified, and how their testimony related to other facts in the case, the Court can easily conclude that the Debtors' testimony was not credible. The Debtors' action in placing the Eureka Funds in their personal checking account was not within their normal business practices. As pointed out above, the extensive use of the personal account, in the month of January 1997, was far from the norm, and the documentary evidence in the form of canceled checks shows that the Debtors were paying, not only bills from the business, but also numerous personal obligations. Thus, the Debtors' actions as shown by the documentary evidence belie the testimony of the Debtors at trial. While finding that the testimony of the Debtors was not credible, the Court further finds that the testimony offered by Plaintiff's witnesses was credible and logical when measured against the actions of the Debtors as supported by the documentary evidence submitted by the Plaintiff.

In conclusion, the Court finds that the Debtors' actions in spending the funds from the Eureka Contract, in the amount of \$57,461, was a willful and malicious injury causing damage to Magna Bank, N.A. as is required under 11 U.S.C. § 523(a)(6). In making this finding, the Court concludes that the Bank has met its burden of proof by a preponderance of the evidence as required in Grogan v. Garner, 111 S.Ct. 654 (1991). Accordingly, judgment shall be entered in favor of Magna Bank, N.A. and against the Debtors in the sum of \$57,461, plus interest at the rate of 9% per annum from January 6, 1997, until the judgment is paid in full.

ENTERED: June 29, 1998.

/s/ GERALD D. FINES
United States Bankruptcy Judge